Q&A

Property option drop explained

Our Head of Investments, Leigh Gavin, explains why our Property investment option has experienced a drop in its returns over the final few months of 2016.

Q: Earlier this year I decided to put some of my super balance into your Property investment option.

Given that property is booming at the moment I can't understand why the returns have been low. What's happening and should I change my investment options?

LG: It's important to state up front that our listed property portfolio is not invested in residential property. Instead, it's 100% invested in a passive A-REIT* portfolio otherwise known as 'listed property trusts' (or LPTs). This listed property portfolio is focused on the commercial sector, which includes office buildings, shopping centres and industrial sheds. These commercial assets have not performed as strongly as residential property has.

Further, all the companies in the passive A-REIT portfolio such as Westfield, Stockland, GPT and Vicinity (who own Chadstone Shopping Centre) are listed on the Australian stock exchange (ASX). This makes them far more exposed to share market volatility.

Plus, share markets are forward-looking. This means that they price in what may be on the front page of future newspapers rather than what might appear on the front page of the newspaper today.

Q: So why has LUCRF Super's Property investment option performed so well in the past?

LG: In recent years interest rates have fallen. When this occurs, investors generally search for yield in other areas, including listed property. Listed property trusts are often known as a 'bond proxy 'on the share market.

This activity meant that the companies listed in the property portfolio (such as Westfield) performed very well, better than on the overall share market. It also points to why our Property investment option was able to deliver such strong returns.

These companies did particularly well in 2015/16; certainly much better than what we would expect if interest rates were higher.

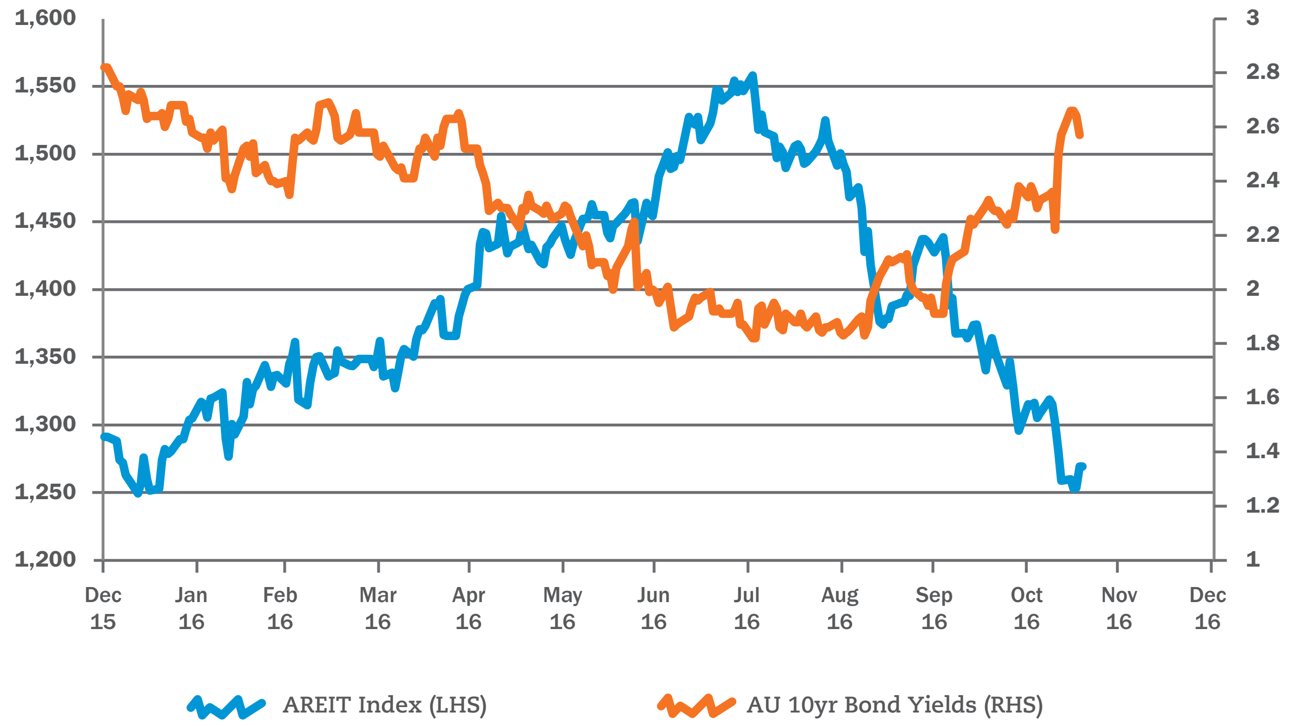
Q: Why the change?

LG: In the last four months or so, this upward trend has reversed because people are expecting interest rates to increase. Bond yields are rising (which means that bond prices are falling) and the share prices of 'bond proxies' (like listed property) are also falling. It's a trend that's continued since the US election.

Search YouTube for 'LUCRF Super' to view our video investment series.

*A-REIT is an acronym for 'Australian Real Estate Investment Trust'

A-REIT Index (LHS) vs AU 10yr Bond Yields (RHS)



Source: CBRE Global Investors, Bloomberg.

Q: How does the US market affect us?

LG: The market expects that the Trump administration will spend up to US$1trillion on new infrastructure as well as look to introduce corporate and personal tax cuts.

In the short to medium term this might turn out well for the US economy, but it's likely that it will also result in inflation. If so, the US Federal Reserve is likely to raise interest rates to control inflation.

Because the Australian market is linked to the US market, we can expect the same sequence of events to happen here. So even though the broader Australian share market has been up post-election, listed property trusts have fallen in value.

Q: What might happen next?

LG: Going forward we can expect more volatility. Listed property will probably recover if bond prices recover and the share market holds up (given that its returns are inextricably linked to shares and bonds).

The best way to guard against volatility is a well-diversified portfolio. So in answer to your question, this may not be a great time to be overly concentrated in one asset class (like listed property).

Find out more about your personal investment risk profile by taking our superannuation investment choice questionnaire or our pension investment choice questionnaire.

Alternately speak with one of our qualified financial advisers to discuss your individual investment profile.

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